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Vietnam: a question of balance

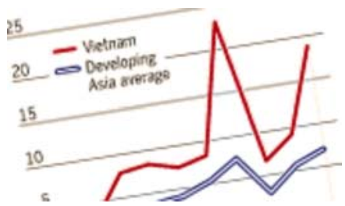
By Ben Bland

Leadership shows few signs of addressing inequality

Bags and baskets: the French quarter of Hanoi. Breakneck growth has led to a widening in inequality, high inflation, a lack of confidence in the currency and fears of a banking crisis

Schooled in the arts of Marxist-Leninist political discipline, Vietnam's Communist rulers do not usually air their dirty linen in public. But, at a government forum on the country's deepening economic crisis in Hanoi last month, tempers boiled over.

When one former central bank governor attempted to blame the country's woes on developed world governments "captured by greedy financial institutions" he received a finger-wagging rebuke. Tran Xuan Gia, a steely former investment minister, urged Vietnam's leaders to look inward to understand why their country suffers from the highest inflation rate in Asia. He warned that the country was on the verge of a debt crisis and urged the government to reform and sell off inefficient state-owned companies as soon as possible.



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Just five years ago, Vietnam was the darling of foreign investors in search of the next hot emerging market after China, where Soviet-style stagnation had been transformed into an economic boom by a reforming Communist party. Manufacturers from US chipmaker Intel to Canon, the Japanese electronics group, set up shop, enticed by the large, cheap labour force in a nation of nearly 90m people. Dozens of South Korean and Taiwanese contract manufacturers, making everything from wooden furniture to garments, migrated from southern China, where wages are three times higher. By 2010, Vietnam was the biggest source of footwear for Nike, the global sports brand.

At the same time, with one of the fastest-growing middle classes in Asia, Vietnam attracted a growing number of international portfolio investors and consumer brands keen to profit from surging domestic demand in this increasingly status-conscious country.

But the Bentleys, iPhones and Louis Vuitton bags on show in central Hanoi and Ho Chi Minh City, while a sign of the country's remarkable economic success, also hint at deeper, structural imbalances. The government's focus on breakneck growth at the expense of economic stability has led to growing inequality, soaring inflation, a lack of confidence in the currency and fears of a banking crisis.

Domestic overheating, coupled with the deterioration of the global economy, has forced many investors, foreign and Vietnamese, to revise their view of the country's prospects. Deep-seated problems, such as corruption, poor education and infrastructure bottlenecks – all often overlooked by investors in the boom years – have moved into sharp focus.

And with inflation driving wages higher but labour skills not advancing as quickly, fresh questions are arising. Among them is whether Vietnam's Communist party can force through painful reforms needed to ensure they avoid the "middle-income trap" ensnaring the likes of Malaysia and Thailand, whose economies are a source of cheap labour but not yet makers of higher-value products.

To many analysts, Vietnam serves as a warning of the pitfalls facing the region, even as Europe and the US struggle with their own economic crises. The Asian Development Bank has warned that Asia's rise is not preordained – and that nations such as Vietnam, as well as China, will need to take tough political choices.

"The Vietnamese government is trying to use small plasters to stem a lot of bleeding," says one senior Asian diplomat in Hanoi. "But in an increasingly competitive world, the risk is that investors just vote with their feet and go elsewhere."

That would further deplete already modest state coffers and create a significant jobs shortfall in a country where the government's legitimacy derives from its ability to ensure employment for the fast-expanding workforce.

A bigger question is whether authoritarian regimes can develop high-income economies while sustaining a political system that curtails public debate and fails to promote the establishment of the strong, independent institutions needed to combat corruption and wasteful state spending.

The country's potential as a leading Asian manufacturing hub – and its pitfalls – can be seen at Thang Long Industrial Park, built on paddy fields outside Hanoi by Japanese conglomerate Sumitomo and its Vietnamese state-owned partner. Opened in 2000, it quickly attracted Japanese companies keen to capitalise on cheap labour and develop an alternative production base to China, increasingly prone to rising wages and outbreaks of nationalistic hostility.

The industrial park was full by 2009, with 55,000 people working for 95 mostly Japanese companies: assembling printers for Canon, refrigerators for Panasonic and the wing flaps for Boeing 737s. But persistently high inflation, today more than 20 per cent year on year, is taking its toll – in Thang Long and other industrial zones across Vietnam. At least 10 of the manufacturers at the park have been hit by wildcat strikes this year, according to Tomoyasu Shimizu, its general manager, as migrant workers struggle to survive on wages as low as 2m dong ($96) a month.

Operating on slim margins, many factories are reluctant to boost wages – and are struggling to find workers. On the site's noticeboard, Canon is offering inducements such as 5kg of free rice a month and cheap accommodation. This is in addition to monthly wages of 2.9m dong and a twice-yearly pay rise.

"Some companies have a higher salary but a bad working environment and it's very expensive to live around here, so I need to be careful what I choose," says Nguyen Manh Hung, a recently arrived 20-year-old worker. "But I had to come here because there are no jobs in my province."

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Difficulties are in evidence across the country. A series of interest rate hikes, started this year as the government belatedly moved to get a grip on monetary policy, has delivered a hard blow to the economy. The key refinancing rate stands today at 15 per cent. Thousands of businesses have been forced to close, record numbers of strikes have broken out and bad debts have soared. Enquiries from new foreign investors have slowed dramatically, according to lawyers and consultants.

Gross domestic product, which rose an average 8.1 per cent a year from 2003 to 2007, is forecast to slow to 6 per cent in the five-year period to 2012, according to the World Bank.

The grim global economic picture only adds to the problems of a country heavily dependent on the export of garments, shoes and commodities such as rice and coffee.

But, as Mr Gia, the former minister, made clear, officials cannot simply export the blame. The dramatic inflation problem owes much to a drive to breed a stable of industrial “national champions” that resulted in a large expansion in credit, much of it channelled to wasteful state-owned enterprises and favoured private businesses. In the past five years, total credit in the economy has doubled to 120 per cent of GDP.

Rising prices have resulted, in effect, in “inflation taxing” of the population, says Dominic Mellor of the ADB in Hanoi. Food prices rose 32 per cent in the 10 months to October.

High inflation has also undermined confidence in the dong, which is pegged to the dollar and has been regularly devalued in recent years to ease pressure on the government’s limited foreign exchange reserves. The currency’s weakness has driven a flight to gold and dollars. Purchases of gold by the Vietnamese are among the world’s highest per head. This has helped the Vietnamese to weather the recent storm, thanks to the long-term gold bull run, but puts further downward pressure on the dong.

This has all appeared to overwhelm the government of Nguyen Tan Dung, prime minister, and the country’s ruling cadre – most of whom are alumni of Soviet-era institutions. Rather than pursuing further reforms, they have resorted to knee-jerk, backward-looking measures, including a crackdown on free speech, curbs on the import of luxury goods and restrictions on visas for foreign workers.

“The pace of reform has slowed,” says Ben Bingham, who recently left Vietnam after four years as the International Monetary Fund’s senior representative. “The government has found the [economic] environment more difficult to manage [since joining the World Trade Organisation in 2007] than it imagined.”

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Social discontent appears to be on the rise, with land protests becoming common in Hanoi, as hard-up farmers complain that they have been short-changed by officials selling their land to well connected businesses on the cheap.

Some Vietnamese officials have conceded to foreign diplomats that they are worried about an Arab spring-type rising breaking out. Diplomats say this is likely to be little more than an attempt to justify a continuing crackdown on human rights.

Corruption is a serious problem, though the benefits are shared more equally than in Arab dictatorships toppled this year. Graft and weak governance remain significant obstacles for investors, particularly since the American and British governments began strict enforcement of laws against bribing overseas officials.

Navigating Vietnam’s complex, slow and often corrupt bureaucracy is a demanding task. Multinationals such as India’s Tata Steel and Nokia, the Finnish mobile phone producer, have seen their high-profile manufacturing investments in Vietnam delayed by red tape and political infighting.

The litmus test for Vietnam will be whether the government can finally reform the wasteful state-owned enterprises that dominate the economy.

The issue came to a head last year, with the near collapse of Vinashin, a heavily indebted state-owned shipbuilder. Johanna Chua, an economist at US bank Citigroup in Hong Kong, believes the government will disappoint investors on this front. “Despite escalating talk of divestment [of state-owned enterprises] and restructuring, we think strong vested interests and a weak global market backdrop next year will likely slow reforms,” she wrote in a recent note to clients.

Jonathan Pincus, who heads Harvard University’s economics teaching programme in Ho Chi Minh City, believes that – without urgently increasing the quality of education and infrastructure and cutting inefficient public spending – Vietnam will find it impossible to become an east Asian tiger like South Korea or Taiwan rather than a flagging crony capitalist state.

“Vietnam is replicating the southeast Asian model of inward-looking conglomerates profiting from speculation and government favours like Thailand and Indonesia in the 1980s,” he says.

Mr Pincus believes the problems have become so entrenched that something big has to change if Vietnam is to live up to its huge potential.

“The government is running out of scope for improvising and some hard decisions will have to be made,” he says.

“There will be political repercussions. But they’ve done it before, doing things that are politically difficult because their backs are against the wall.”